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SUBJECT: RECENT IRANIAN ECONOMIC INVOLVEMENT IN IRAQ

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    1B. 2007 BASRAH 109  
    1C. 2007 LONDON 4680  
    1D. 2007 BAGHDAD 4184  
    1E. 2007 BAGHDAD 3903  
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    1H. 2007 BASRAH 115  
    1I. 2007 HILLAH 158  
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    1K. 2007 BAGHDAD 3976

Classified By: Political Military Counselor Marcie Ries for reasons 1.4  
(b) and (d)

1.(S//NF) SUMMARY: Iran,s economic policy in Iraq, designed in part to win the &hearts and minds8 of Iraqis according to many analysts, has increased in level and scope in recent months, resulting in Iran steadily gaining more economic and political influence in Iraq. Recent reports have indicated Iranian economic activity is broadening to encompass more service provision investment, greater entry into markets outside of border provinces, and greater cooperation on many other levels. Many sources have reported that most Iranian investment and business deals are headed or influenced by the Iranian Revolutionary Guards Corps-Quds Force (IRGC-QF). Ordinary Iranian businessmen have thus far expressed little eagerness for investing in or dealing with Iraq, preferring to focus their business on more lucrative and less risky markets. Official Iranian government numbers on non-oil exports to Iraq are only 7.5% of total Iranian non-oil exports, indicating that Iraq is not a priority private sector market destination for Iranian goods. However, Iran has recently announced that Iraq is its number two trading partner. Mixed in with trade is Iran,s declared \$1 billion in aid to Iraq, which can confuse the picture between trade and assistance. Iranian subsidies to reconstruction projects and cheap Iranian imports hinder Iraqi production and local agricultural output as they are lowering Iraq,s competitive advantage in many industries. This economic campaign is believed to have underlying political motives of building relations and ties with various Iraqi groups and sectors in several areas, in addition to benefiting politically influential Iranians, many of whom have intelligence or security connections. END SUMMARY

#### INCREASED IRANIAN ECONOMIC ACTIVITY IN IRAQ

2.(S//NF) Recent cables and open-source reporting indicate that Iran is enlarging its economic footprint in Iraq by increasing its trade links (primarily imports to Iraq, especially in the south), deepening cooperation in the oil sector, raising its investment levels in service provision, and trying to increase and strengthen ties with Iraq,s holy areas. Iraqi and U.S. sources in Iraq, particularly in the south, have suggested that this deepening of economic ties and increased investment is connected in part to an overall strategy to gain political influence in Iraq.

## BILATERAL TRADE FAVORS IRANIAN IMPORTS

3.(U) While Iran has released data on trade with Iraq, accurate numbers cannot be determined due to the reportedly vast smuggling along the long border. In October 2007, Iranian Deputy Commerce Minister Mehdi Ghazanfari was quoted in Iranian press as saying that Iraq had become Iran's second highest trading partner due to a 17.5% increase in non-oil exports from March to July 2007. Total official Iranian numbers on trade with Iraq were \$1.216 billion in 2006, of which only \$16 million were imports from Iraq. Percentages of Iraqi exports to Iran out of total bilateral trade have ranged from only one to three percent in public announcements. Other released Iranian numbers claim that trade solely with the Kurdish region reached \$1 billion in 2006. (Note: When Iran closed the Kurdish border after PJAK attacks in September 2007, traders loudly protested. End Note) In November, Iranian FM Mottaki valued the current level of mutual trade at \$2.2 billion. In January, head of the Iran-Iraq Joint Chamber of Commerce, Industries, and Mines Hassan Tizmaghz said the value of Iran's exports to Iraq would reach \$2 billion by the end of the current Iranian year (March 19). According to Ghazanfari, Iranian exports to Iraq only counted for 7.5% of Iranian total non-oil exports, so it can be inferred that the bulk of the trade is oil-related, and that Iraq is not a private-sector, primary market for Iranian goods. However, the Deputy Commerce Minister claimed that Iran supplies Iraq with 56% of its general market needs such as food, books, and clothing. Mixed in with trade is Iran's declared \$1 billion for aid to Iraq, which may account for differences in statistics.

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## FOCUS ON THE SOUTH

4.(C) In addition to the Kurdish region, much of the Iranian exports to Iraq go to southern Iraqi markets, particularly to Basrah. According to Basrah Governor Wa'eli in a March 2007 press interview, imports from Iran total \$45 million per year and encompass a range of goods such as carpets, construction materials, and food. Wa'eli said in 2006 100-150 commercial trucks entered Iraq from Iran daily near the Shalamcha border crossing.

(C) These trade numbers will likely rise upon completion of a transborder railway project. On January 4, Iraqi transportation ministry officials announced their support of an Iraq-Iran railway from Basrah to Iran via Shalamcheh in Southwest Iran. Part of the Iranian portion of the railway has been completed. The rest of the \$110 million railway is supposed to be constructed by Iranian companies, according to Iranian press. Iran announced that part of its \$1 billion assistance package for Iraqi reconstruction is allotted to railway construction.

## OIL

5.(C) Oil trade accounts for the majority of legitimate and illegitimate Iran-Iraq trade. Recent events such as the oil, gas, and petrochemical conference on January 3 in Tehran suggest that both sides want to increase the volume of oil trade. At this event, Iran announced it would build 250 oil wells in Iraq, each costing more than \$60 million, in the next several years. In November, Iraq's South Oil Company announced a deal to build a pipeline between Basrah and Iranian ports at Abadan to increase Iraqi oil exports and diversify its export routes. According to open source reports, Basrah's total current oil exports are 200,000 barrels of crude oil per day. After two years of inaction on the pipeline project, PM Maliki and Oil Minister Shahrastani went to Tehran in August 2007 to sign an agreement to begin the project, according to the Iraqi head of the project, Director General of the State Company Oil Projects, Falah

al-Khawaja. The agreement is to build two pipelines, one for exporting Iraqi crude to Iran and the other for importing Iranian derivatives, or refined fuels. The exporting pipeline is a 32-inch pipeline, while the derivative pipeline is half of that size. According to Iranian press sources, the pipeline will deliver between 100,000 to 200,000 bpd of Iraqi crude (ref A). (Note: Specifics of the deal, including the crude export price have not been reported. End Note)

6.(C) Basrah governor Wa,eli (Fadhila) in a November 19 meeting with REO Basrah criticized the pipeline project, saying it would allow for greater Iraqi crude exports and would not guarantee derivative imports from Iran. He also said the pipeline would not create more jobs for Iraqis since Iranians are given most of the work. The head of the project, Falah, claimed he insisted that Iraqis build the Iraqi part before he would sign the agreement (refs A, B).

7.(C) According to Falah, as well as Governor Wa,eli and Asri Mousa, the planning manager for the South Oil Company, this pipeline deal is a political project that will not provide Iraq with any economic benefits, including derivative imports from Iran. Governor Wa,eli said this pipeline plan was a part of Maliki,s policy to assist Iran, which includes allowing Iran to unfairly benefit from oil extraction in the shared Majoon oil field, according to Basrah reporting (ref B). The southern oil field is situated on the border, and although Wa,eli says the Iraq side has the capacity to extract 500,000 bpd, only 50 to 70,000 bpd are extracted. Wa,eli accused Maliki of trying to quietly benefit Iran by allowing it to extract at much higher rates, in effect giving them Iraqi oil. He further claimed that oil flows only go from Iraq to Iran; no oil or derivatives from Iran enter southern Iraq, including very little black market imports. He attributed this to adequate local supply and high Iranian demand for energy. (Note: While some derivative imports may come through Iran to Iraq, they tend to originate in other countries. End Note)(ref A, B).

8.(C) Wa,eli also claimed that oil smuggling to Iran is rampant from offshore oil terminals and seaports. Reports of oil smuggling have been seconded by other REO Basrah contacts, who say that oil is siphoned from pipelines and wells and smuggled through the ports in Iraqi and Iranian vessels (ref B).

9.(C) In contrast to above comments, however, the British Embassy in Baghdad reported that its office in Basrah had not picked up on any local resentment or ill-will regarding oil contracts with Iran.

SERVICE PROVIDER

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10.(S//NF) One area in which Iran seems to be investing heavily in Iraq is service provision, especially electricity. According to a January 1 MNF-I Combined Intelligence Operations Center (CIOC) Assessment, &Iran continues to invest in Iraq,s infrastructure to pursue its Information Operations campaign with Iraqi Shi,a, leveraging the Iraqi government,s need for foreign investment and improved infrastructure.8 At the beginning of 2007, the Iranian government announced that it was ready to assume major responsibility for Iraqi reconstruction. Iran has continuously increased its investment in Iraqi reconstruction, especially in basic and necessary services. By March 2007, Basrah and Diyala were importing cheap electricity from Iran by connecting to Iran,s electric grids. In October, Iran,s Deputy Energy Minister announced that Iran,s power grid would be connected to nine locations in Iraq and that Iran would build power plants in Iraq. Iran is currently building power plants in Karbala and Najaf -- two Shia holy sites -- and in Sadr City, a Shi,a stronghold in Baghdad. Construction of the shared power plant between Karbala and Najaf began in December. Different sources

provide cost estimates of \$75 million or between \$200 and \$300 million for the plant. Much of the cost was donated by the Iranian government, according to Iraq's Minister of Electricity, Karim Wahid.

11.(S//NF) On January 3, an Iranian Energy Ministry representative met with Karbala Governor Aqil Al Khazali and said that after the current 180mw power plant is completed, Iran will build two more power stations in Karbala and Najaf.

The Iranian representative also stated Iran will compete with international companies to build a power station in Khairat. Khazali also called for the Iranian government to carry out various other service projects in Iraq. The Sadr City 160mw power plant was reported in open sources in October to cost \$150 million. The plant will be under Iranian control, not under control of the Iraqi Ministry of Electricity, according to an Iraqi government source from MNF-I reporting. Iranian company Sunir won this contract by offering an affordable loan repayment plan that will only begin in 2017. These plants are intended not only to provide Iraqis with electricity but also with jobs, seemingly part of the campaign to win hearts and minds. The Sadr City plant began hiring Iraqis in mid-December.

12.(U) In the last several months, Iran has gained greater entry into the banking and financial sector in Iraq. The Iraqi Central Bank gave permission to Iran's Bank Sepah to open a Baghdad branch in May 2007. In June, Bank Melli Iran opened its first Iraqi branch in Baghdad. Also in the summer, the first joint Iraq-Iran bank, established by Iran's Eqtasad Novin Bank and Bank Keshavarzi and an Iraqi bank, opened in Baghdad. In December, the consortium opened a Karbala branch designed to provide services for Iranian pilgrims, and a third branch in Najaf is estimated to open soon. Other branches in Basrah, Irbil, and Sulaymaniyah are scheduled to open within the year.

13.(U) In December, Iran's Housing Minister expressed a desire to enter the Iraqi housing market and build new developments around the country. The Iraqi Housing Minister said the GOI will approve a law in 2008 to attract foreign investment, especially in the housing markets, since the government wants Iran to build 2.5 million housing units in Iraq by 2010.

14.(U) Iran is also exploring offering education services. In October, the president of Iran's Islamic Azad University and the Iraqi Ambassador to Iran discussed steps to open an Iraqi branch of IAU. (Note: IAU has other overseas branches. End Note)

#### IRANIAN INVESTMENT HIGH IN SHIA HOLY AREAS

15.(U) Recent open source reporting has shown that the Iranian government and officials of Iraqi holy areas have been working on deals to increase the numbers of Iranian pilgrims visiting Iraq. In December, Najaf officials said publicly that they made deals with Iranian tour companies to bring several more million pilgrims to the city every year. Recent estimates of Iranian pilgrims entering Iraq are 2,500 per day according to Iraqi Ambassador to Iran, Mohammed Majid al-Sheikh. In March 2007, provincial tourism officials estimated that 22,000 Iranian pilgrims visit Najaf and 10,000 visit Karbala monthly. These numbers can be expected to increase dramatically as Iran forms new tour companies to shuttle pilgrims to Iraq. The current numbers of pilgrims visiting are unverified, but Iran in November called for increasing six-fold the number of pilgrims allowed into Iraq to three million per year from the current level of 500,000. Iranian Ambassador to Iraq Kazemi-Qomi said that this

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increase could deepen ties between the two countries.

16.(S//NF) In December, Mohammed Ali Khatami, claiming to be a past member of IRGC, told London PolOff that Iranian NGOs

supporting Iranian pilgrimages to Iraq are headed by IRGC-QF commander Soleimani and his deputy Firouzandeh. He claimed that they run several companies operating in Basrah, Amara, Karbala, Najaf, Al Nasariya, Diyala, Wasit, and other areas (ref C). (Note: Khatami,s credibility has not been established. End Note)

17.(U) Iran is investing heavily in construction and improvement efforts to help these areas accommodate the growing number of pilgrims. Money from Iran is financing shrine expansion projects in Najaf, tourist facilities such as rest houses, wells, and restrooms near the shrines, and other development projects to improve and expand the holy cities. In March 2007, Governor of Najaf Asaad Abu Galal said publicly that the Iranian government gave the Najaf government \$20 million a year and the Karbala government \$3 million a year to build and improve tourist facilities for pilgrims.

#### RECENT COOPERATION

18.(U) In a January 3 bilateral economic and trade cooperation conference in Iran, Iranian Minister of Economy Jafari announced that expanding economic cooperation with Iraq was on Iran,s agenda. The conference was specifically focused on oil, gas, and petrochemical industries and how the two countries can increase their cooperation in these fields. At the end of the year, Iraqi officials were also reportedly in discussions with the director of the Iranian Kish Free Trade Zone about how to further business cooperation and trade between the countries. The Iraqi Ambassador to Iran said that the two sides are looking to hold bilateral trade exhibitions, use the island for athletic training for Iraqi athletes, and have education facilities for Iraqi students.

#### IRAN GAINING INFLUENCE: ECONOMIC AND POLITICAL

19.(S//NF) Reports of Iran gaining political influence in Iraq, especially in the south, continue. In December, Colonel Ali al-Khawam, the leader of Muthanna,s Criminal Intelligence Unit, said that Basrah province is almost completely under Iranian control, which he claimed is part of Iran,s overall strategy to control and indirectly govern southern Iraq. One U.S. Iraqi source, Saad Ouda al-Mussawi, confirmed Iranian interference in Maysan province and said economic reconstruction offices in the major cities of the south are staffed by Iraqi Arabs operating under Iranian control and direction. He added that Iran has repeatedly engaged with tribal leaders throughout the south (ref D).

20.(S//NF) According to the UK Ambassador to Iran, the Iranian business sector expresses little interest in the Iraqi market, indicating the possibility that much trade is controlled by entities with links to the Iranian government. British officials believed that most of the large black and gray market with Iraq is likely mostly controlled by the IRGC (ref E). (Note: Iranian sources claimed to IRPO Dubai that only former IRGC officials have the courage and the connections to operate in the insecure climate in Iraq (ref F). End Note)

#### IRANIAN INVESTMENT AND TRADE UNDERCUTTING IRAQI INDUSTRY

21.(C) Several reports and Iraqi contacts have noted the negative effects that Iranian investment (including subsidies) and cheap imports have on Iraqi production and investment. Akeel Razzak, CEO of Iraqi Al Bilal Group, said on January 3 to NEA officials that Iranian and Turkish subsidies for companies building power plants and investing in the private sector undercut Iraqi firms, competitiveness. With the Iranian government funding an increasing number of projects related to construction, investment, and reconstruction of Iraq, Iraqi companies do not have a competitive advantage in taking the lead on many deals (ref G). Likewise, cheap Iranian imports in the Iraqi markets have a detrimental effect on supporting domestic industry and production. According to Iraqi sources in Basrah, Hillah, and Diyala and PRT Karbala, cheap Iranian products in the

local economy have effectively driven out Iraqi agricultural products since Iranian goods are half the price of domestic produce. A once thriving agricultural industry is having difficulties competing against Iranian imports, and there are no local Iraqi goods in the bustling revived markets. In a province that relies heavily on agricultural jobs, as does much of the country, farmers cannot compete with cheap Iranian imports, and to a lesser extent imports from Syria and other neighboring countries. Although Iraqi consumers are benefiting from cheaper consumer goods, the Iraqi dinar

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is flowing out of the country rather than being reinvested in Iraq production and capital. (Ref H-K)

22.(S//NF) COMMENT: These factors, considered in conjunction with Iran,s ties to segments of the Iraqi political scene, seem to indicate that Iran is trying to expand its political influence in Iran through trade and assistance, although given geographic proximity and longstanding cultural ties, some Iran-Iraq trade is normal and beneficial. Just as we did not try to sever Afghan-Iran trade ties in our efforts to normalize the situation there and reconstruct the country, we are not overtly discouraging Iraqi trade with Iran. However, trade relations bear close scrutiny, as it seems from many sources that much of the investment and trade is controlled and directed by the IRGC-QF, which indicates that Iranian economic interests have political underpinnings. Reporting indicates that many Iranian front companies operate in the south and funnel money back to Iran in order to pay for Iraqi militia support and training. We can expect Iranian economic and political influence to rise as Iran invests more heavily throughout Iraq, not just in the south, increases the numbers of Iranian pilgrims visiting Iraq, and continues to dominate Iraqi local markets with Iranian goods. END COMMENT

CROCKER